UK Dividend Monitor

Link Asset Services

Issue 35 – Q3 2018

Part of **Link Group**

UK equities have been firmly out of favour with investors for some time. With Brexit negotiations supposed to conclude imminently, but no apparent progress on the future trading arrangements between the UK and the EU yet having been made, share prices have been rangebound. This is especially so for mid-cap and smaller companies, whose fortunes depend more on the health of the domestic economy.

Profitability, however, is relatively healthy, and that is feeding ongoing growth in dividends. Moreover, the pound was weaker in the third quarter than it was at the same time last year, and enters the fourth quarter markedly lower still against the dollar. This will boost the sterling value of dividends paid between now and December.

In the latest quarterly Link Asset Services UK Dividend Monitor, we consider the most recent trends in UK dividend payments, and the outlook for 2018.

Contents

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Executive Summary

Overview

- Q3 dividends totalled £32.3bn, a third-quarter record, and an increase of 4.1% on a headline basis
- Banks, mining companies, and new issues helped boost the total ahead of expectations
- Underlying dividends, excluding specials, rose 6.9% to £31.6bn, an all-time quarterly record
- Special dividends were lower year-on-year, while a weaker pound produced a small exchange rate gain, instead of an expected penalty in Q3

Sectors & Companies

- Mining companies overtook the oil sector to become Q3's largest payers
- They contributed most to growth, as companies continued to restore dividends to former levels, but this effect is set to wane from here on
- Banking dividends have started to grow much more quickly, though HSBC is an outlier
- Most sectors saw flat or growing payouts; where there were declines these were mainly due to isolated companies, or one-offs
- Retail, however, stands out for its weakness
- BP increased its payout for the first time since 2014, raising hopes of an increase from Shell, the world's largest dividend payer, next year

Top 100 v Mid 250

- Top 100 dividends outperformed the mid-caps overall, as the strongest sectors mainly comprised top 100 stocks
- Median growth was higher among mid-caps at company level

Yield

- Falling share prices and rising dividends meant that equity yields jumped from 3.9% to 4.1%
- A sharp rise in bond yields to 1.6% is still well below the level provided by shares

Outlook

- Banking dividends are set to go from strength to strength, with RBS returning to dividends in the fourth quarter
- Renewed sterling weakness will reduce the exchange-rate penalty for the year too
- Headline dividends upgraded by £1.1bn to a record £99.5bn, an increase of 4.8%
- Underlying dividends (excluding specials) are set to reach £95.8bn, also a record, and an increase of 8.6%

Overview

Banks, mining companies, and new issues helped boost total dividends ahead of expectations in Q3

Underlying growth, excluding specials, **rose 6.9% to £31.6bn**, an all-time quarterly record

By the end of September, more than £4 in every £5 of 2018's dividends had reached shareholders, completing the seasonal peak that began in April. Q3 dividends totalled £32.3bn, a headline increase of 4.1%, and a record for the third quarter.

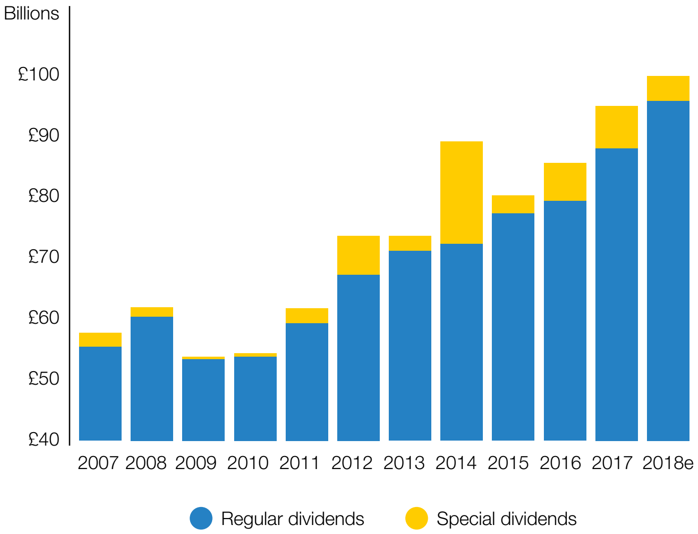
Q3 exceeded our expectation for growth of 1.9%, thanks in particular to a strong showing by banks and mining companies. There was an additional boost from Quilter, which made its June stock market debut with a bang by immediately declaring a large £230m special dividend. Separately, the pound weakened, meaning that the sterling value of the very large portion of UK dividends declared in US dollars and euros was given a boost. There was also good news for BP's shareholders, who enjoyed the first increase in their dividend, in dollar terms at least, in four years. BP's 2.5% hike was small, but marks an important milestone for the sector and reflects brightening prospects.

Underlying growth, which excludes special dividends, was an impressive 6.9%, in line with the second quarter. The underlying total paid was an all-time quarterly record of £31.6bn.

“Q3 dividends totalled £32.3bn, a third-quarter record, and an increase of 4.1% on a headline basis.”

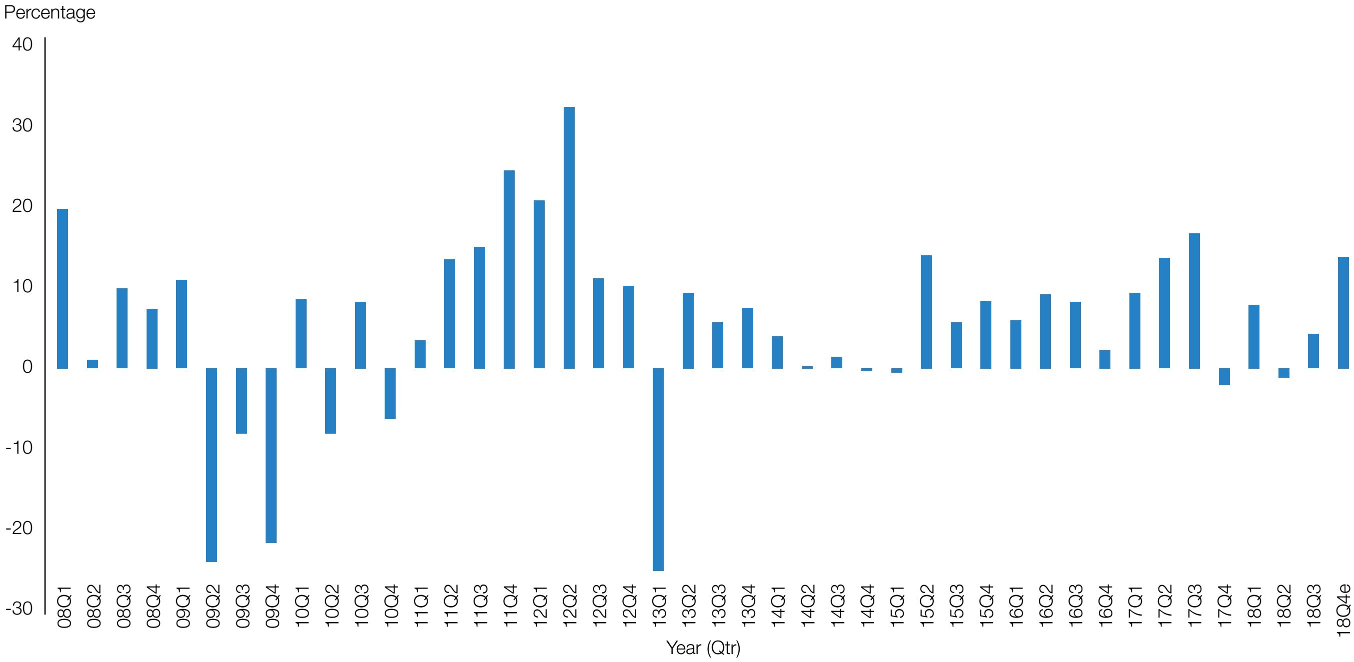
Dividends Paid £bn	Q1	Q2	Q3	Q4	Full Year
2007	£9.6	£20.2	£15.6	£11.9	£57.2
2008	£11.4	£20.3	£17.1	£12.7	£61.6
yoy	*19.8%*	*0.7%*	*9.7%*	*7.4%*	*7.7%*
2009	£12.7	£15.4	£15.7	£9.9	£53.7
yoy	*10.7%*	*-24.5%*	*-8.2%*	*-21.9%*	*-12.9%*
2010	£13.7	£14.1	£16.9	£9.3	£54.1
yoy	*8.4%*	*-8.1%*	*8.1%*	*-6.4%*	*0.8%*
2011	£14.2	£16.0	£19.5	£11.6	£61.4
yoy	*3.6%*	*13.6%*	*15.2%*	*24.8%*	*13.5%*
2012	£17.2	£21.3	£21.7	£12.8	£73.0
yoy	*20.9%*	*32.8%*	*11.1%*	*10.5%*	*18.9%*
2013	£12.8	£23.3	£22.9	£13.8	£72.9
yoy	*-25.4%*	*9.6%*	*5.7%*	*7.3%*	*-0.2%*
2014	£27.8	£23.4	£23.2	£13.7	£88.1
yoy	*116.8%*	*0.3%*	*1.3%*	*-0.4%*	*21.0%*
2015	£13.3	£26.7	£24.6	£14.8	£79.4
yoy	*-52.2%*	*14.2%*	*5.8%*	*8.3%*	*-9.9%*
2016	£14.1	£29.5	£25.0	£16.8	£85.5
yoy	*6.3%*	*10.2%*	*2.0%*	*13.4%*	*7.6%*
2017	£15.4	£33.4	£28.5	£17.0	£94.4
yoy	*9.1%*	*13.5%*	*13.9%*	*1.1%*	*10.5%*
2018e	£17.2	£33.0	£32.3	£17.0	£99.5
yoy	*10.6%*	*-1.1%*	*4.1%*	*13.6%*	*4.8%*

UK dividends

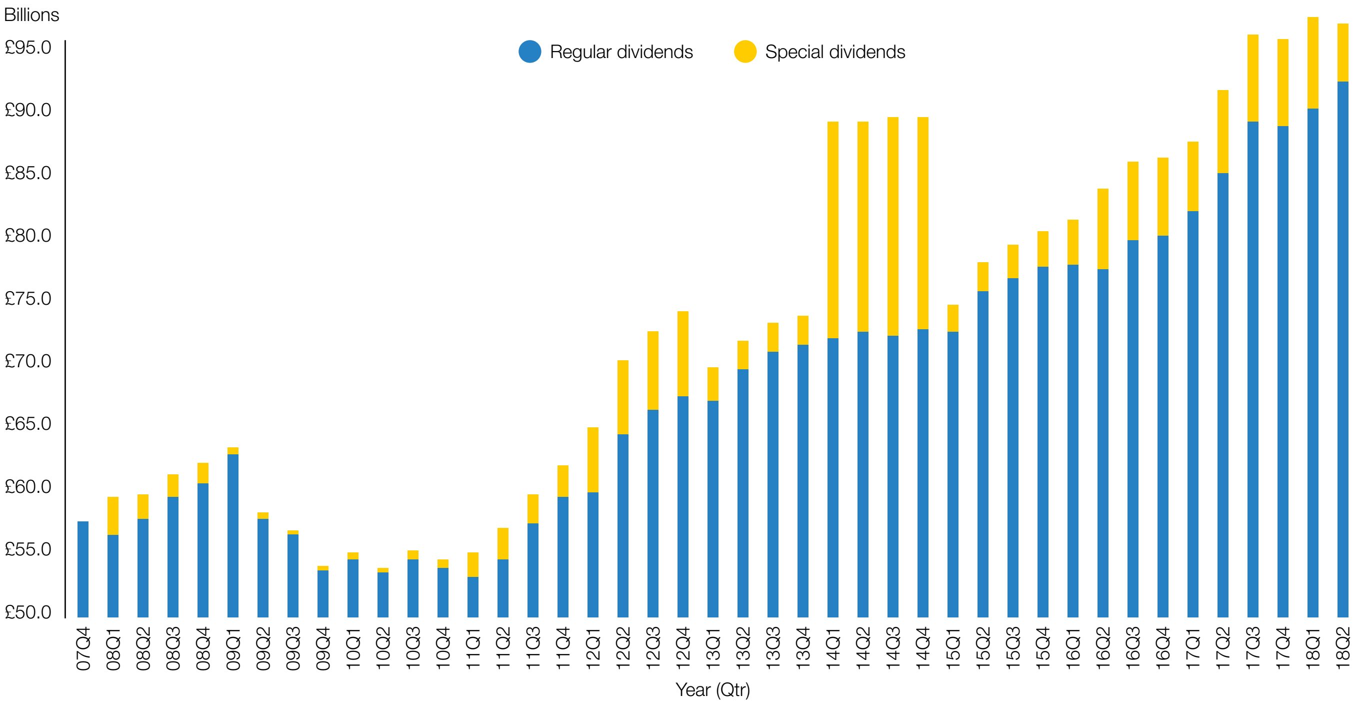


Overview, continued

Growth in quarterly dividends, year-on-year



Rolling 12-month dividends



Special Dividends & Exchange-Rate Factors

Special dividends were lower year-on-year

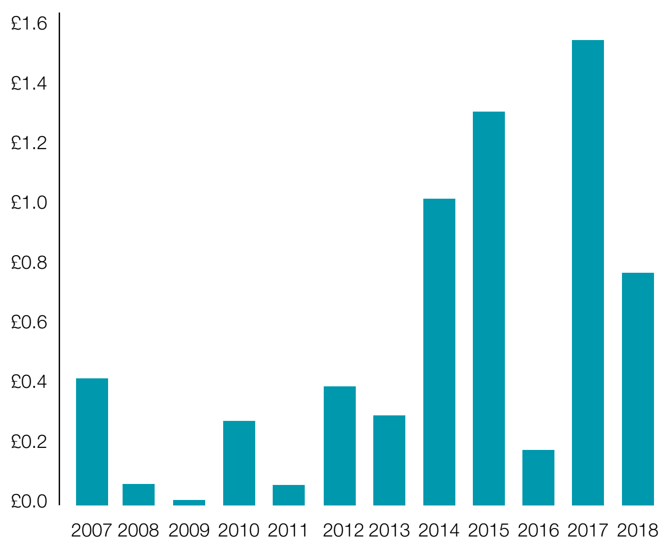
A weaker pound produced a small exchange rate gain, instead of an expected penalty in Q3

Special dividends were much lower year-on-year, explaining why headline growth was slower than underlying growth. Specials are by their nature very unpredictable, since they often relate to one-off events such as asset disposals, or because the management judges that profits have been unusually strong, especially in highly cyclical industries. They were particularly large in Q3 2017, thanks to a £1bn payout from food services group Compass. They fell by half in Q3 2018 to £755m (slightly lower than we expected). Taylor Wimpey was the largest contributor, distributing £340m, the fourth consecutive special from the group. Benign conditions for housebuilders, boosted by money from the government's Help to Buy scheme, have meant huge profits across the sector, which is currently just passing the peak of its cycle. Wealth manager Quilter's special represented the partial sale proceeds of its funds arm.

The pound reversed its early 2018 strength during the third quarter. The £93m exchange-rate penalty we had pencilled in, turned into a £44m gain in Q3.

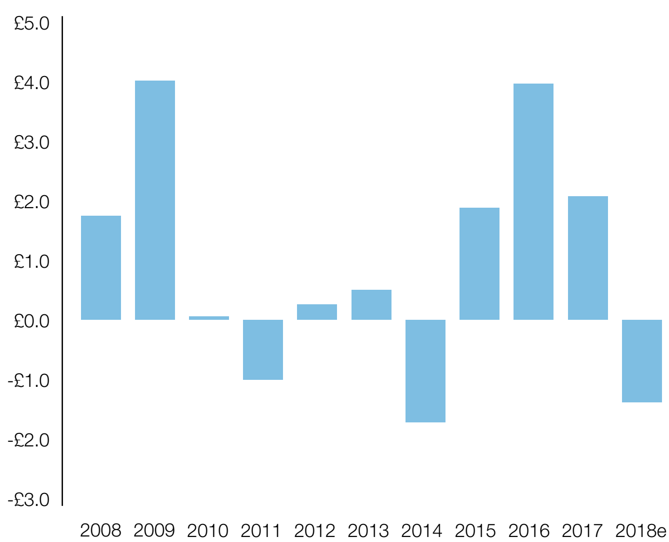
Q3 Special dividends

Billions



Exchange rate boost/penalty (full year basis)

Billions



Sectors & Companies

Mining companies overtook the oil sector to become **Q3's largest payers**

Miners contributed most to growth, with many restoring dividends to former levels, but this effect is set to wane

Banking dividends have started to grow much more quickly, though HSBC is an outlier

Mining companies have been a core driver of dividend growth in the last two years, as they recovered from the 2015-16 commodity crash. This continued in Q3. Miners not only overtook the oil sector to become the largest payers in Q3, but they also contributed most to dividend growth, up £1.4bn year-on-year, an increase of 41%. The last of the commodities groups to restore its dividend to full strength was Glencore, which almost tripled its payout to £1.1bn. BHP and Evraz also made large increases. The other majors, Anglo American and Rio Tinto showed more modest growth, having begun to restore their payouts last year. The catch-up effect will wane quickly now, especially as earnings are beginning to disappoint analyst expectations and market conditions are tougher. Commodity prices have recovered some of their poise after trade-war-induced wobbles, but the easy profit gains from higher prices have passed for now.

In the banking sector, sharply higher profits meant Barclays raised its interim payout by 150%, an increase of £257m year-on-year. Its final dividend is likely to jump too when it is declared next year. The bank had cut its payout to the bone as it absorbed the impact of hefty fines from the US regulator. Lloyds continued its winning streak, raising its payout by a tenth. Smaller banks also did well. HSBC, once again, made no increase. Payouts from general financials and insurance were flattered by Quilter's debut special, but there was strength across the board – only two companies out of thirty saw lower payouts. Average dividend growth was just over 10%.

Dividends from industrial goods and support were hit by the cancellation of Capita's payout, but most companies in the sector made modest increases. One-offs affected consumer goods, and airlines, travel and leisure. Healthcare was flat.

Retail stood out as a more structural weak spot. Most retailers held their dividends flat, among them M&S and Dixons Carphone, or made very made modest increases, e.g. Sainsbury's. The overall total fell, however, even after adjusting for the removal of Booker from the index on its acquisition by Tesco, thanks in particular to a big cut at Next, which did not pay its perennial special this year. Debenhams' meagre dividend was halved. The much-publicised difficulties on the high street have squeezed profits hard, which in turn is putting pressure on dividends. Food retailers are doing a little better, but there is no sign of pressure on general retailers ending any time soon.

The three largest payers in the UK, Shell, HSBC, and BP, made up 27% of UK dividends in 2017, meaning investors in UK equities are unusually reliant on a handful of stocks for their income. Until now, none of these has shown any growth in dollars (their reporting currency) since 2015, when HSBC made a modest 2% hike. The oil majors have not increased since 2014. The lack of growth from these three giants has acted as a significant drag on UK dividends in recent years. 2018's total UK dividends would be almost £2bn higher if they had increased payouts in line with the wider market.

Rapidly improving free cash flow in the oil sector is now changing that picture. BP's 2.5% hike in its most recent dividend is very encouraging, and will be worth around £150m to its shareholders over the next year. If Shell follows suit in the coming months, that would add another £300m. Years of restructuring at HSBC have held back progress, but if interest margins continue to widen, there may yet be scope for it to consider following suit as well. Even small increases from the three largest payers would underpin UK dividend growth in future.

"The much publicised difficulties on the high street have squeezed profits hard, which in turn is putting pressure on dividends."

Sectors & Companies, continued

Dividends – top companies

Rank	07Q3	08Q3	09Q3	10Q3	11Q3	12Q3
1	Vodafone Group	Vodafone Group	Vodafone Group	Vodafone Group	Vodafone Group	Vodafone Group
2	Royal Dutch Shell	BP	BP	Royal Dutch Shell	Royal Dutch Shell	Royal Dutch Shell
3	HSBC Holdings	Royal Dutch Shell	Royal Dutch Shell	HSBC Holdings	HSBC Holdings	HSBC Holdings
4	BP	HSBC Holdings	HSBC Holdings	GlaxoSmithKline	GlaxoSmithKline	BP
5	BT Group	BT Group	GlaxoSmithKline	Tesco	National Grid	National Grid
Subtotal £bn	*£6.2*	*£7.1*	*£7.4*	*£7.1*	*£7.4*	*£7.8*
% of total dividends	*40%*	*42%*	*48%*	*42%*	*38%*	*36%*
6	GlaxoSmithKline	GlaxoSmithKline	Tesco	British American Tobacco	BP	GlaxoSmithKline
7	Tesco	Tesco	National Grid	BHP Billiton	Tesco	British American Tobacco
8	National Grid	National Grid	British American Tobacco	National Grid	British American Tobacco	Tesco
9	British American Tobacco	BHP Billiton	BHP Billiton	AstraZeneca	BHP Billiton	BHP Billiton
10	SSE	British American Tobacco	AstraZeneca	SABMiller	AstraZeneca	AstraZeneca
11	AstraZeneca	AstraZeneca	SSE	SSE	SABMiller	SABMiller
12	Taylor Wimpey	SSE	SABMiller	Rio Tinto	Rio Tinto	Rio Tinto
13	Segro	SABMiller	Reckitt Benckiser Group	Reckitt Benckiser Group	SSE	SSE
14	BHP Billiton	Taylor Wimpey	Man Group	BT Group	Reckitt Benckiser Group	BT Group
15	SABMiller	Anglo American	Imperial Tobacco Group	Man Group	BT Group	Reckitt Benckiser Group
Subtotal £bn	*£3.9*	*£4.5*	*£4.5*	*£5.0*	*£6.2*	*£6.7*
Top 15 Grand Total £bn	*£10.1*	*£11.6*	*£11.9*	*£12.1*	*£13.7*	*£14.6*
% of total dividends	*65%*	*68%*	*76%*	*73%*	*70%*	*67%*

Rank	13Q3	14Q3	15Q3	16Q3	17Q3	18Q3
1	Vodafone Group	Vodafone Group	Vodafone Group	Royal Dutch Shell	HSBC Holdings	HSBC Holdings
2	Royal Dutch Shell	Royal Dutch Shell	Royal Dutch Shell	Vodafone Group	Royal Dutch Shell	Royal Dutch Shell
3	HSBC Holdings	HSBC Holdings	HSBC Holdings	HSBC Holdings	Vodafone Group	Vodafone Group
4	BP	BP	BP	BP	BP	BP
5	National Grid	National Grid	National Grid	SABMiller	British American Tobacco	Rio Tinto
Subtotal £bn	*£8.5*	*£7.1*	*£7.5*	*£9.0*	*£11.3*	*£11.1*
% of total dividends	*37%*	*30%*	*30%*	*34%*	*36%*	*34%*
6	GlaxoSmithKline	GlaxoSmithKline	Rio Tinto	National Grid	Compass Group	British American Tobacco
7	British American Tobacco	British American Tobacco	GlaxoSmithKline	British American Tobacco	Rio Tinto	Glencore
8	Tesco	Tesco	British American Tobacco	BT Group	BT Group	BT Group
9	SABMiller	Rio Tinto	SABMiller	GlaxoSmithKline	National Grid	BHP Billiton
10	BHP Billiton	BHP Billiton	BHP Billiton	AstraZeneca	GlaxoSmithKline	National Grid
11	Rio Tinto	SABMiller	AstraZeneca	SSE	AstraZeneca	GlaxoSmithKline
12	AstraZeneca	AstraZeneca	BT Group	Lloyds Banking Group	Lloyds Banking Group	AstraZeneca
13	SSE	BT Group	SSE	Rio Tinto	BHP Billiton	Lloyds Banking Group
14	BT Group	SSE	Lloyds Banking Group	Reckitt Benckiser Group	SSE	SSE
15	Glencore Xstrata	InterContinental Hotels Group	Glencore	WPP	Anglo American	Anglo American
Subtotal £bn	*£7.2*	*£7.4*	*£7.6*	*£7.2*	*£8.7*	*£9.1*
Top 15 Grand Total £bn	*£15.7*	*£14.4*	*£15.1*	*£16.2*	*£20.0*	*£20.2*
% of total dividends	*68%*	*62%*	*61%*	*61%*	*64%*	*62%*

Sectors & Companies, continued

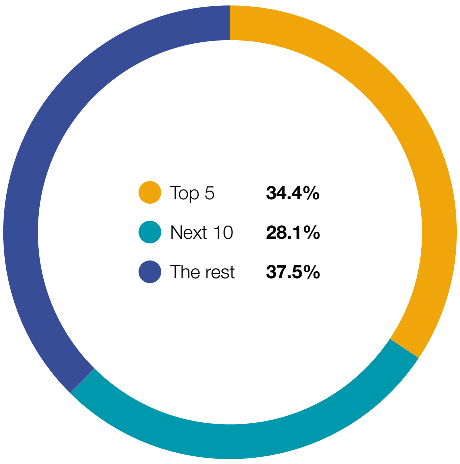
Dividends – by industry

Industry £m	Resources & Commodities	Consumer Goods & Housebuilding	Retail & Consumer Services	Banks & Financials	Healthcare & Pharmaceuticals	Industrials	Oil, Gas & Energy	Information Technology	Telecoms	Domestic Utilities	Total
07Q3	£971	£1,529	£2,514	£2,424	£995	£602	£2,326	£36	£3,231	£945	**£15,573**
08Q3	£1,020	£1,940	£2,522	£2,368	£1,101	£639	£2,769	£26	£3,611	£1,064	**£17,058**
09Q3	£697	£1,738	£1,906	£1,738	£1,252	£628	£3,397	£52	£2,973	£1,274	**£15,654**
	-32%	*-10%*	*-24%*	*-27%*	*14%*	*-2%*	*23%*	*103%*	*-18%*	*20%*	***-8%***
10Q3	£1,473	£2,315	£1,916	£2,032	£1,421	£620	£2,173	£71	£3,517	£1,411	**£16,950**
	111%	*33%*	*1%*	*17%*	*14%*	*-1%*	*-36%*	*38%*	*18%*	*11%*	***8%***
11Q3	£2,021	£2,614	£2,353	£2,142	£1,556	£655	£2,741	£87	£3,758	£1,594	**£19,521**
	37%	*13%*	*23%*	*5%*	*10%*	*6%*	*26%*	*22%*	*7%*	*13%*	***15%***
12Q3	£2,800	£2,829	£2,441	£2,352	£1,572	£940	£3,024	£74	£3,801	£1,857	**£21,689**
	39%	*8%*	*4%*	*10%*	*1%*	*43%*	*10%*	*-15%*	*1%*	*17%*	***11%***
13Q3	£2,558	£3,185	£2,495	£2,703	£1,643	£1,128	£3,293	£174	£4,013	£1,802	**£22,995**
	-9%	*13%*	*2%*	*15%*	*5%*	*20%*	*9%*	*136%*	*6%*	*-3%*	***6%***
14Q3	£2,726	£3,526	£3,148	£2,924	£1,625	£1,349	£3,349	£78	£2,732	£1,922	**£23,380**
	7%	*11%*	*26%*	*8%*	*-1%*	*20%*	*2%*	*-55%*	*-32%*	*7%*	***2%***
15Q3	£2,960	£3,461	£2,188	£4,223	£1,667	£1,590	£3,614	£89	£2,927	£1,998	**£24,718**
	9%	*-2%*	*-31%*	*44%*	*3%*	*18%*	*8%*	*14%*	*7%*	*4%*	***6%***
16Q3	£1,060	£4,054	£2,585	£6,118	£1,906	£1,306	£4,358	£78	£3,158	£2,078	**£26,700**
	-64%	*17%*	*18%*	*45%*	*14%*	*-18%*	*21%*	*-12%*	*8%*	*4%*	***8%***
17Q3	£3,478	£3,667	£3,347	£6,730	£1,911	£1,698	£4,534	£161	£3,517	£2,036	**£31,079**
	228%	*-10%*	*29%*	*10%*	*0%*	*30%*	*4%*	*106%*	*11%*	*-2%*	***16%***
18Q3	£4,856	£3,563	£2,271	£7,453	£1,894	£1,698	£4,688	£263	£3,531	£2,131	**£32,347**
	40%	*-3%*	*-32%*	*11%*	*-1%*	*0%*	*3%*	*64%*	*0%*	*5%*	***4%***

Dividends – by sector

Sector £m	17Q3	18Q3	change year on year
Mining	£3,336	£4,703	41%
Food & General Retailing	£142	£153	8%
Industrial Goods & Support	£53	£14	-74%
General & Life Insurance	£266	£275	3%
Information Technology	£3,348	£3,275	-2%
Building Materials & Construction	£779	£826	6%
Beverage & Food Producers	£951	£754	-21%
Healthcare & Pharmaceuticals	£1,618	£691	-57%
General Financials	£4,062	£4,278	5%
Banks	£1,018	£1,354	33%
Media	£1,163	£1,277	10%
Oil, Gas & Energy	£488	£544	12%
Property	£1,911	£1,894	-1%
Airlines, Leisure & Travel	£58	£96	67%
Industrial Chemicals	£1,641	£1,602	-2%
Consumer Goods & Housebuilding	£4,534	£4,688	3%
Telecoms	£161	£263	64%
Domestic Utilities	£3,517	£3,531	0%
Motor Manufacturing & Parts	£2,036	£2,131	5%

Concentration of dividend payments among UK companies – Q3 18



Top 100 v Mid 250

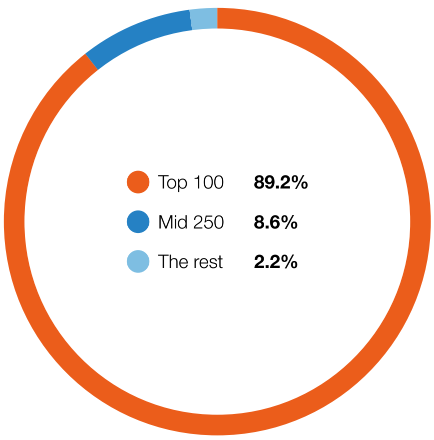
Top 100 dividends outperformed the mid-caps overall, as the strongest sectors mainly comprised top 100 stocks

Median growth was higher among mid-caps at company level

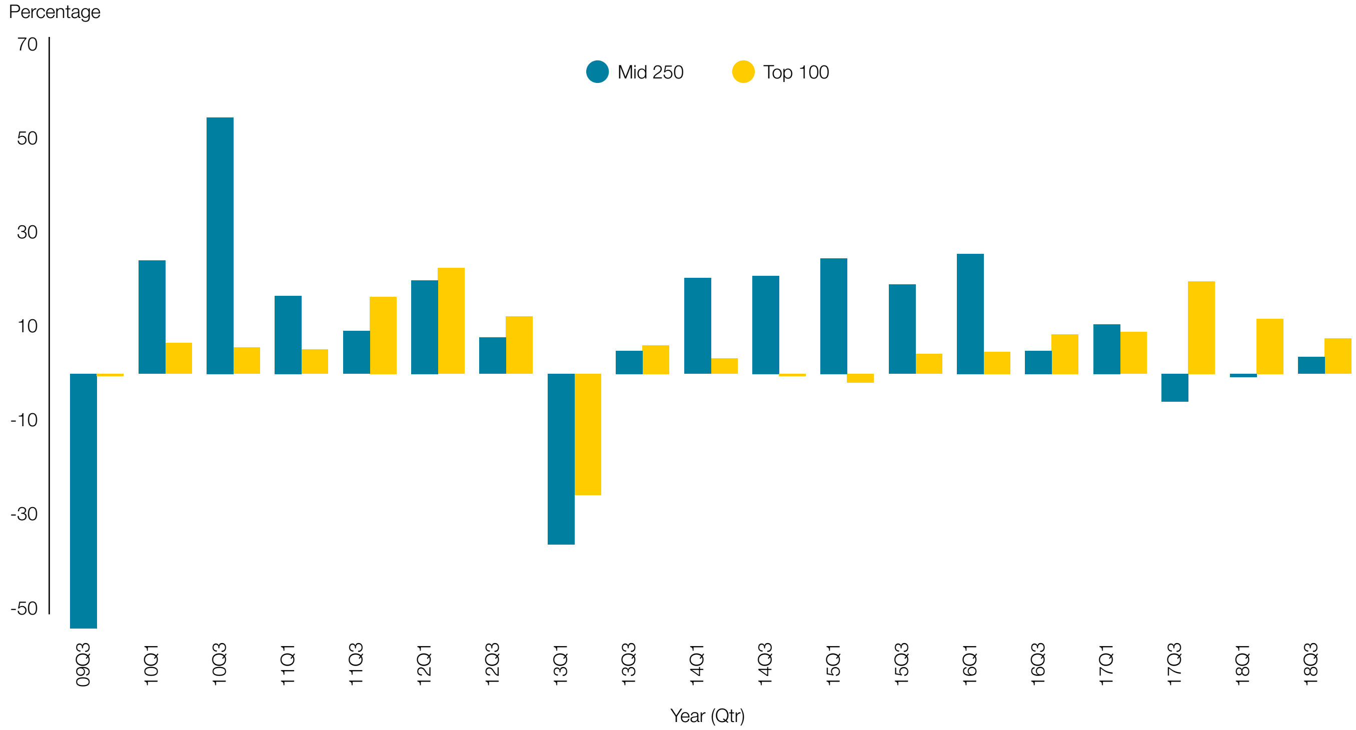
Top 100 dividends rose 3.7% in Q3, held back by much lower special dividends. On an underlying basis they were 7.1% higher. Mid-cap payouts lagged behind, rising just 2.7% on an underlying basis. In their case, however, higher specials meant headline growth was faster at 7.4%.

Underlying mid-cap dividend growth has been slower than the top 100 in every quarter this year. The sector distribution helps explain the picture. The exceptionally strong performance of sectors like mining and banks is concentrated among the larger stocks. Meanwhile, a couple of large mid-caps that have cut, like Capita, have had a disproportionate impact on the mid-cap picture. Median dividend growth in Q3 was higher among the mid-caps than it is among the top 100. Profit growth is solid too. All this suggests so we should be wary of drawing too many conclusions from the apparent underperformance.

Q3 Share of UK Dividends



Top 100 v Mid 250 – annual growth per quarter



“The exceptionally strong performance of sectors like mining and banking is concentrated among the larger stocks.”

Yield

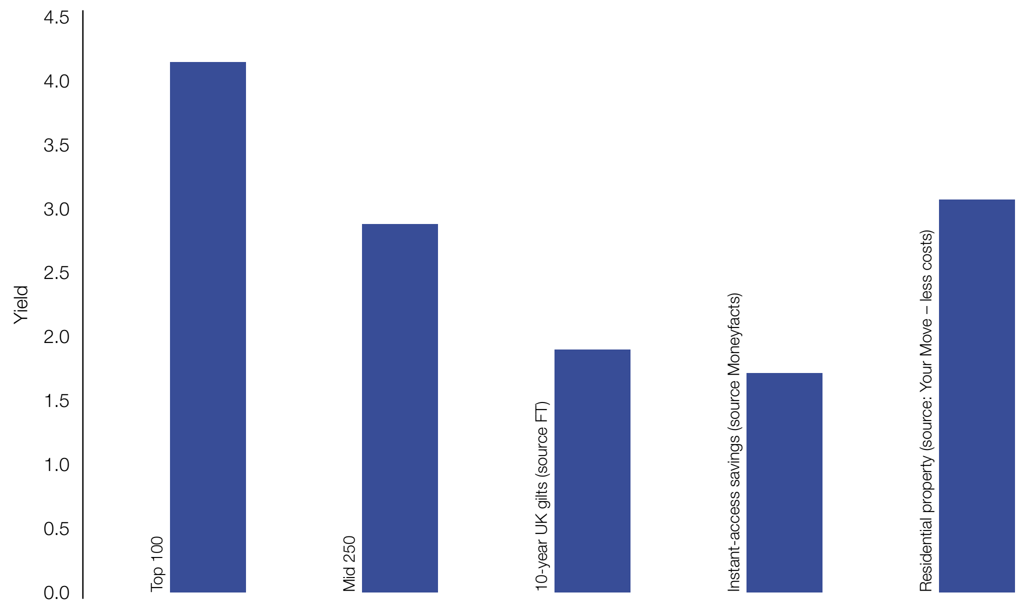
Falling share prices and rising dividends meant that equity yields jumped from **3.9%** to **4.1%**

A sharp rise in bond yields to **1.6%** is still well below the level provided by shares

UK share prices fell during the third quarter even as dividends have continued to grow. That has pushed up the prospective 12-month yield from equities. Collectively they are set to yield 4.1%, up from 3.9% at the end of June. The top 100 will yield 4.3%, while the mid-caps will yield 2.7%. Bond yields rose sharply over the quarter, reflecting rising interest rates around the world. Even so, the UK 10-year gilt still only yields 1.6%, well below the income on shares. Property yields and cash interest rates lag behind too.

UK Income

Percentage



Outlook

Banking dividends are set to go from **strength to strength**, with RBS returning to dividends in the fourth quarter

Headline dividends upgraded by **£1.1bn** to a record **£99.5bn**, an increase of **4.8%**

Underlying dividends (excluding specials) are set to reach **£95.8bn**, also a record, and an increase of **8.6%**

After another great quarter for investors, 2018 dividends are getting set to finish on a high.

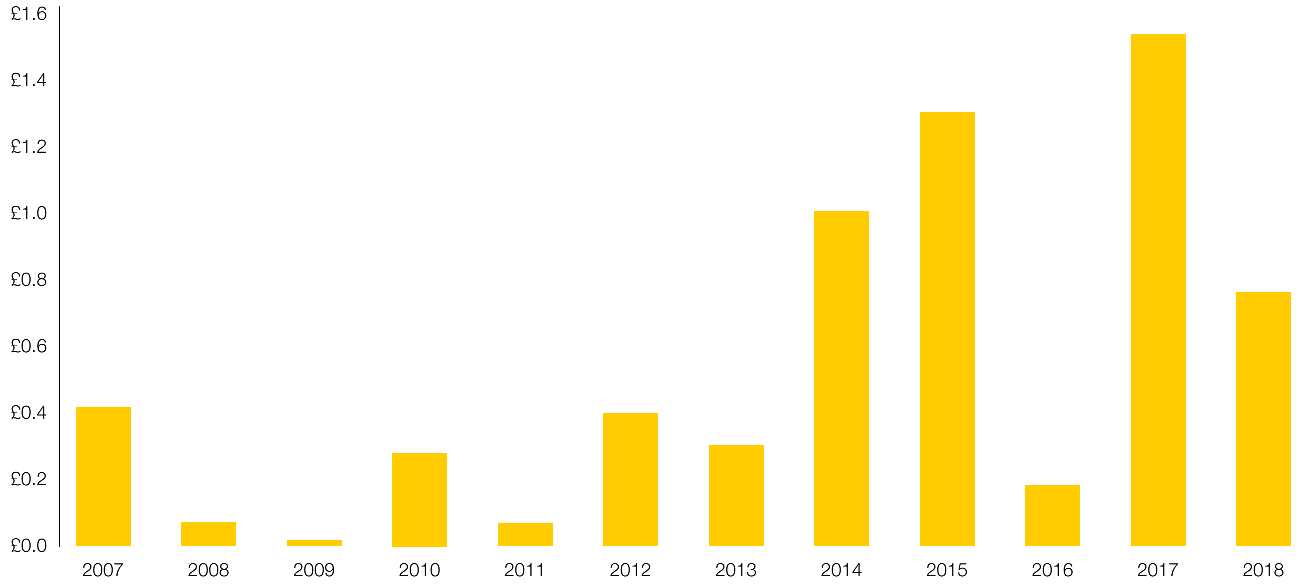
Most sectors are producing steady growth, but it is quite common for one or two to be enjoying a particularly good run. Just as the upside from mining dividends will now begin to slow, good news from the banking sector means it can take up the baton of growth, at least in part. In the fourth quarter, Standard Chartered will make its first interim payment since 2015, having paid its first final earlier this year, and RBS will finally return to paying dividends after 10 long years since the financial crisis. We expect it to distribute £240m in October, but the bank has significant surplus capital and has not ruled out a large special dividend, perhaps next year. In the year ahead, there should be more growth to come from Barclays and Lloyds too.

On average in 2018, the pound will be stronger than it was in 2017 against the dollar and euro, meaning there will be an exchange-rate drag of £1.4bn for the year, following three years where its weakness provided a consistent boost. As recent bouts of volatility demonstrate, it is notoriously difficult to forecast FX rates. As such, we merely use the rate at the end of the latest quarter. By the end of Q3, the pound's early 2018 recovery against the dollar had petered out, meaning the penalty for the full year is likely to be lower than we initially forecast. In fact, there is likely to be a further exchange-rate gain in the fourth quarter, based on the current level of the pound.

We have increased our forecast for headline dividends by £1.1bn. One-quarter of this change comes from the renewed weakness in the pound, and one-fifth from RBS. The rest reflects the stronger-than-expected Q3, as well as new announcements of payments to be made in the fourth quarter. We now expect headline dividends to total a comfortable record of £99.5bn for 2018, an increase of 4.8%. Underlying dividends (which exclude specials) are set to reach £95.8bn, also a record, and an increase of 8.6%.

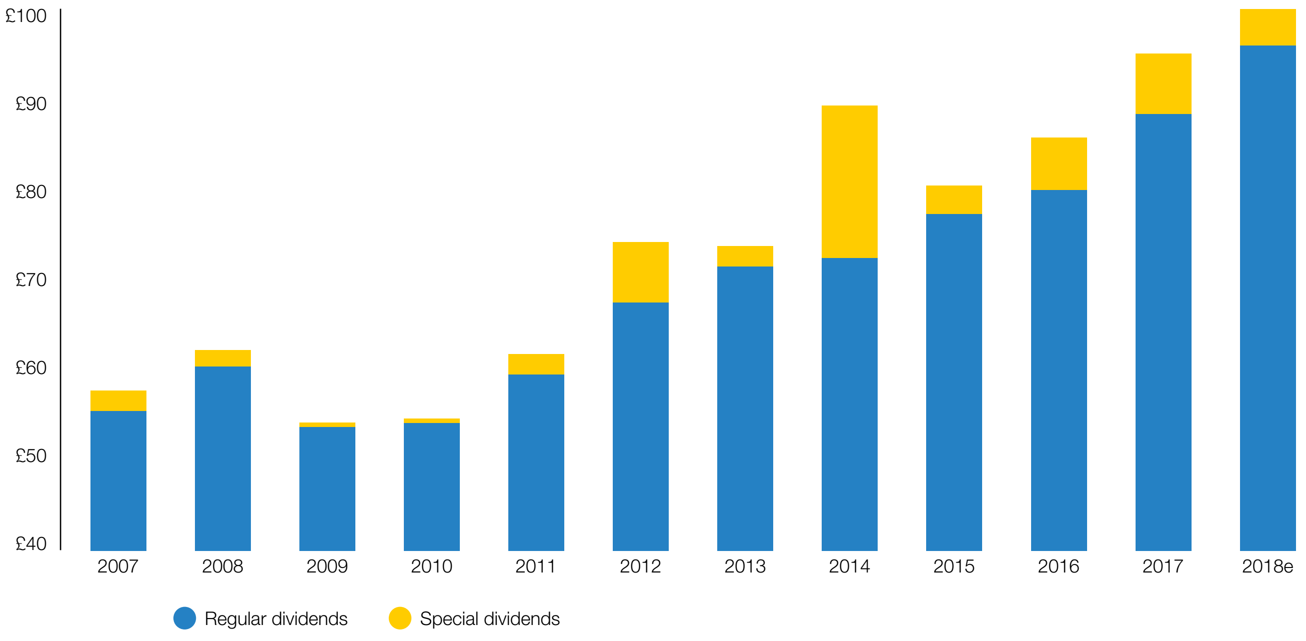
Q3 Special dividends

Billions



UK dividends (full year basis)

Billions



Statistical Methodology

Link Asset Services analyses all the dividends paid out on the ordinary shares of companies listed on the UK Main Market. The research excludes investment companies such as listed investment trusts, whose dividends rely on income from equities and bonds. The Dividend Monitor takes no account of taxation on dividends, which varies according to investor circumstances. The raw dividend data was provided by Exchange Data International, and additional information is sourced directly from companies mentioned in the report.

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